DEPARTMENT OF STATE REVENUE

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Supplemental Letter of Findings: 01-20180011; 01-20180012; 01-20180013; 01-20180014
Individual Income Tax
For the Years 2009 through 2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Supplemental Letter of Findings.

HOLDING

Despite providing supplementary documentation intended to describe in detail the means and methods by which it determined the extent to which Indiana Electrical Contractor's employees were engaged in specific projects, Electrical Contractor failed to establish that it was entitled to Research and Development credits because Electrical Contractor did not engage in experimental activities which led to the discovery of new and improved methods of installing electrical components which then were available to the community of electrical contractors.

ISSUE

I. Adjusted Gross Income Tax - Qualified Research Expense Projects and Documentation.

Authority: IC § 6-3-1-3.5(b); IC § 6-3.1-4-1; IC § 6-3.1-4-2(a); IC § 6-3.1-4-4; IC § 6-8.1-5-1(c); IC § 6-8.1-5-4; IC § 6-8.1-5-4(a); *IDOPCP, Inc. v. Comm'r*, 503 U.S. 79 (1992); *New Colonial Ice Co. v. Helvering*, 292 US. 435 (1934); *United States v. McFerrin*, 570 F.3d 672, 675 (5th Cir. 2009); *Stinson Estate v. United States*, 214 F.3d 846 (7th Cir. 2000); *Suder v. Commissioner of Internal Revenue*, T.C. Memo. 2014-201 (T.C. October 1, 2014); *Conklin v. Town of Cambridge City*, 58 Ind. 130 (1877); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); I.R.C. § 41(d); I.R.C. § 41(d)(1); I.R.C. § 41(d)(1)(A); I.R.C. § 41(d)(1)(B); I.R.C. § 41(d)(1)(B)(i); I.R.C. § 41(d)(1)(B)(ii); I.R.C. § 41(d)(1)(C); I.R.C. § 41(d)(4)(B); I.R.C. § 41(d)(4)(B), (C); Treas. Reg. 1.41-4(a)(3); Treas. Reg. 1.41-4(a)(3)(i); Treas. Reg. 1.41-4(a)(3)(ii); Treas. Reg. § 1.41-4(d); Treas. Reg. § 1.6001-1(a)

Taxpayer argues that it conducted qualified, experimental research activities, that it can adequately document the wage expenses related with those projects, and that it is now entitled to claim the benefit of credits associated with the qualifying activities.

STATEMENT OF FACTS

Taxpayers are individual shareholder/owners of an Indiana company which provides full-service electric contractor services. The Indiana company provides electrical installation and contract services to industries, hospitals, schools, universities, and other commercial and industrial customers.

For simplicity's sake, this Supplemental Letter of Findings will hereinafter designate the Indiana company as "Taxpayer" because Indiana company is an S corporation which originally claimed the now disputed credits. Any business income - or tax liability - "passed through" to the individual shareholders.

Taxpayer filed amended 2009, 2010, and 2011 corporate income tax returns. Taxpayer filed the amended three returns "in order to claim a research expense credit." Taxpayer's previously filed an original 2012 return which included research expense credits.

On its 2009 through 2012 returns, Taxpayer claimed approximately $153,000 in credits.

The Indiana Department of Revenue ("Department") reviewed Taxpayer's original and amended returns. In a report issued August 2014, the Department concluded that the projects on which Taxpayer based the $153,000 in research credits "did not meet the definition of 'qualified research.'" In addition, the Department concluded that

Taxpayer was unable to verify the amount of time during which Taxpayer's employees were purportedly engaged in activities which met the definition of "qualified research."

Taxpayer disagreed with the decision denying the credits and submitted a protest to that effect. The protest was dated January 2015.

In the interim and following submission of the January 2015 protest letter, Taxpayer offered to provide additional information that - according to Taxpayer - supported its claim to the research and development ("R&D") credits. That information was provided to and then reviewed by the Department's Audit Division.

The Department disagreed with Taxpayer's claim that, based on the newly provided information, it was entitled to the R&D credits. The Department concluded that Taxpayer "did not engage in qualified research for the purpose of developing a new or improved business component of the [T]axpayer . . . ." In addition, the Department - in the absence of a time tracking system - "was unable to determine how the [T]axpayer came to [the] qualified wage amounts."

The Department scheduled a hearing on the disputed matters in September 2017; Taxpayer asked for additional time to prepare, and the hearing was rescheduled for December 2017 to accommodate Taxpayer's request. When the December 2017 date arrived, Taxpayer failed to take part in the hearing. As a result, the protest file was "closed" that same month.

Taxpayer sought and was granted a "rehearing." The protest was redocketed and a rehearing was scheduled February 2018. Taxpayer's representatives took part in the February 2018 hearing and during that hearing explained the basis for the original protest.

Following the February 2018 hearing, Taxpayer developed and then provided the Department a detailed methodology by which it purported to reconcile and verify the amount of time its employees were engaged in specific contractor projects.

This Supplemental Letter of Findings results and is based on the original audit, the Taxpayer's supplemental information provided the Department's Audit Division after the audit was completed, the information prepared and provided during the administrative hearing, and the detailed expense information prepared and provided following that hearing.

I. Adjusted Gross Income Tax - Qualified Research Expense Projects and Documentation.

DISCUSSION

The issues are whether Taxpayer has established that it conducted qualifying research and development (R&D) activities and whether it can sufficiently document the amount of labor expenses associated with those R&D activities.

A. Department's Original Audit Examination.

During the years 2009, 2010, 2011, and 2012, Taxpayer claimed approximately $153,000 in Indiana Research Expense Tax Credits ("RECs"). The 2014 audit reviewed the basis for claiming the expenses to determine whether Taxpayer's activities constituted qualifying research and whether Taxpayer could substantiate the labor expenses associated with those activities.

The Department reviewed the information supplied by Taxpayer. The information included descriptions of projects, employee involvement with those projects, and the labor expenses associated with those employees.

The projects at issue during the original audit included:

- Installation of Parking Lot Lights;
- Installation of Lighting in Hospital Emergency Room;
- Installation of "equipment at a customer's location";
- Installation of a Fire Alarm System;
- Updating an Outdated Electrical System.

In the original 2014 audit report, the Department determined that these "projects did not meet the definition of

'qualified research.'" As authority for that conclusion, the 2014 report cited to I.R.C. § 41(d)(4)(B), which provides that qualified research "does *not* include the adaption of an existing business component to a particular customer's requirement or need." (*Emphasis added*).

The 2014 audit report concluded that the projects for which Taxpayer claimed credits were "adaptions of an existing component. [Taxpayer's] projects are not developing new or improved business components . . . ."

The Department also requested from Taxpayer information to "support the employee activities" associated with the claimed projects. According to the 2014 audit report, the Department requested information which "track[ed] each employee to a particular project and contemporaneous interview notes from each employee." The Department sought the information to determine the "percentage of wages . . . allocated for [employee] qualified services."

Taxpayer explained that none of the sought-after information was available.

Thereafter the Department requested that Taxpayer provide a copy of the "Federal Form 6765" (Credit for Increasing Research Activities). Taxpayer stated they were unaware if the federal form had been prepared or - if it had been prepared - if it was then available.

B. Supplemental Audit Division Review Following the Original Audit.

As noted above, Taxpayer provided additional information after the date it first protested the results of the 2014 audit. Taxpayer and the Department agreed to review a sample of six different projects. In its written response, the Department's report stated that the additional documentation was not sufficient to "overcome the 4-part test" required under I.R.C. § 41(d) which defines "qualified research" as research:

> 1. [w]ith respect to which expenditures may be treated as an expense under section 174[;]
> 2. [w]hich is undertaken for the purposes of *discovering information* which is technological in nature (also known as the Discovery Test)[;]
> 3. [t]he application of which is intended to be useful in the development of a new or improved business component of the taxpayer; and
> 4. [s]ubstantially all of the activities which constitutes elements of a process of experimentation for a qualified purpose. (*Emphasis added*).

Specifically, the Department did not agree that Taxpayer's activities led to the discovery of information or technology which expanded upon and added to the common knowledge of other electrical contractors. As authority for its position, the Department cited to Section 1.41-4(a)(3)(i) of the 2001 Final Regulations which states:

> For purposes of section 41(d) and this section, research is undertaken for the purpose of *discovering information* only if it is undertaken to obtain knowledge that exceeds, expands, or *refines the common knowledge* of skilled professionals in a particular field of science or engineering. (*Emphasis added*).

T.D. 8930, 66 F.R. 280-01 at 290.

Rather than "discovering" or "expanding common knowledge," and then documenting the expenses associated with that activity, the Department found that:

> The [T]axpayer is simply doing what is required to be done in the normal practice of [] electrical engineering [and that] the costs are ordinary and necessary business expenses subject to the rules of [I.R.C. § 62] . . . . The [T]axpayer provided no documentation to suggest that the projects they engaged in were beyond that of a normal electrical contractor.

The Department concluded that Taxpayer was not "developing or improving [a] business component" as required by Treas. Reg. 1.41-4(a)(3). The supplemental Audit Division report states that Taxpayer and its clients were simply benefiting from the education and experience of its employees.

> Even though the [T]axpayer may not know every detail of the final design when it first signs the contracts with the customer, both the customer and the [T]axpayer know that the [T]axpayer has the education/experience to prepare the appropriate design based on the customer's requirements and site conditions when [Taxpayer] entered into the contracts.

The Department found that none of the work associated with the six electrical projects "contributed to the development of a new or improved business components" but that the contract work simply duplicated or adapted "existing business components and processes the [T]axpayer and other companies . . . employ on a regular basis."

The Department found that none of the work associated with the sampled electrical projects constituted "elements of a process of experimentation." In bringing the construction projects to successful completion, there was no evidence that Taxpayer "had relied on alternatives in achieving the desired result."

In addition, the Department found that none of Taxpayer's efforts to successfully complete the construction projects resulted in the discovery of knowledge which expanded the common knowledge of other skilled, electrical professionals.

C. Taxpayer's Response.

1. Qualifying Research Projects.

Taxpayer argues that it engaged in qualified research projects on behalf of its clients. Taxpayer explains:

> [Taxpayer's] clients requested that [Taxpayer] develop a new or improved electrical system and design. Thus, the new or improved business component that [Taxpayer] developed during each project is the final, validated, electrical system design that was created and delivered to each respective client. Each business component and the electrical system developed created or improved functionality, durability, reliability and/or quality for the client.

For example, Taxpayer cites to a project in which it updated the electrical system of a university laboratory. The laboratory was originally placed into service in the 1930's and the laboratory required substantial updating of its electrical systems.

In determining the laboratory's modern technological requirements, Taxpayer states that it "performed extensive field evaluations and evaluated the existing electrical system and components before setting out to create the required customer design." The initial laboratory proposal submitted to Taxpayer by the university was found to "not be feasible or constructible given the space constraints within the building." Given that finding, Taxpayer states it was required to develop a new "electrical system from square one and set out to iteratively create a customer solution that would offer the [client] the required functionality within the space constraints of the existing [laboratory] building."

The laboratory's final electrical design was the result of a "systematic process of experimentation" and provided the client a "new and improved functionality." According to Taxpayer, "experimentation" was necessary because it "faced significant uncertainty as to the appropriate design of the new electrical system . . ." for the updated laboratory.

Taxpayer also cites to yet another project it performed for an Indiana hospital. Taxpayer states that in installing the electrical systems, it was faced with numerous "change orders" in the performance of the contract, that although it was originally provided with "preconstruction and site preparation" schematics, Taxpayer was faced with the responsibility of determining the "actual appropriate design for the electrical systems." In other words, the specifications first provided Taxpayer by the client were not sufficient to complete the installation project and Taxpayer was required to utilize its own resources, experience, and expertise to determine the best method for completing the electrical project.

Taxpayer states that in undertaking the experiments associated with each electrical project, it employs "BIM modeling (Building Information Modeling)," "CAD modeling," and "on-site plotting." Taxpayer states it is one of the "innovators in their field" employing a "network infrastructure," "digitized files," "on-site [computer] services," information "backups on [its] office servers," and "virtual [computer] servers."

Because of the complexity and technical nature of its electrical services, Taxpayer states it employs a "professional engineer," and employs in-house "CAD, BIM, and 3-D modeling experts."

2. Wage Expense Documentation.

Taxpayer also objects to the Department's conclusion that Taxpayer was unable to substantiate the employee labor expenses which formed the basis for Taxpayer's R&D claim. Taxpayer states it has provided "sufficient documentation to substantiate that its R&D expenses were at least 6[percent] of its wage expenses."

Taxpayer originally admitted that it did "not maintain a system of project accounting with sufficient detail that [could] be used to quantify the company's research expenses accurately." Taxpayer explained:

> [Taxpayer] does maintain a contemporaneous time-tracking system, but it does not track employee time to specific tasks or phase codes that could be used to determine whether those tasks are qualified research activities during any given project. Thus, in order to ensure accuracy and reliability in the credit claim, [Taxpayer's] time tracking system could not alone be used to capture the qualifying expenses.

Because Taxpayer did not maintain a system of tracking the time during which its employees were purportedly engaged in qualified research projects, Taxpayer "use[d] a series of interviews and estimates to quantify its qualified research expenses."

Taxpayer argues that the law does not require that R&D claimants use anything other than "estimates to quantify qualified research expenses . . . ." Taxpayer states that the Department may not disallow R&D credits "solely because [a] taxpayer relied upon estimates to substantiate the amount of qualified research expenses incurred."

D. Statement of Law.

At the outset, it is important to note that Taxpayer does not raise the question of whether Indiana's version of the Research Expense Credit imposes the T.D. 8930 "Discovery Test" or the less restrictive T.D. 9104 "Uncertainty Test." Taxpayer explains that under either "test," its electrical contract activities constitute "qualified research."

1. Burden of Proof.

Tax assessments are *prima facie* evidence that the Department's assessment of tax is presumed correct; the taxpayer bears the burden of proving that the assessment is incorrect. IC § 6-8.1-5-1(c); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

IC § 6-3.1-4-4 provides that, "'Research expense tax credit' means a credit provided under this chapter against any tax otherwise due and payable under IC 6-3." Similar to deductions, exemptions, and exclusions, tax credits - such as RECs - "are matters of legislative grace." *Stinson Estate v. United States*, 214 F.3d 846, 848 (7th Cir. 2000). The taxpayer who claims the tax credit is required to retain records necessary to substantiate a claimed credit. Where such a credit is claimed "the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 100-01 (Ind. Ct. App. 1974) (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

Citing *Stinson Estate*, the circuit court in *United States v. McFerrin* summarized that "[t]ax credits are a matter of legislative grace, are only allowed as clearly provided for by statute, and are narrowly construed." *United States v. McFerrin*, 570 F.3d 672, 675 (5th Cir. 2009). *See also New Colonial Ice Co. v. Helvering*, 292 US. 435, 440 (1934) ("Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefore can any particular deduction be allowed.")

In order to obtain the benefit of the RECs at issue, both Indiana and federal law require that a taxpayer maintain and produce contemporaneous records sufficient to verify those credits. *See* Treas. Reg. § 1.41-4(d). As provided in that regulation:

> A taxpayer claiming a credit under section 41 must retain records in sufficiently usable form and detail to substantiate that the expenditures claimed are eligible for the credit.

Elsewhere, Treas. Reg. § 1.6001-1(a) provides specifically:

> [A]ny person required to file a return of information with respect to income, shall keep such *permanent* books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.

(*Emphasis added*).

Moreover, Indiana mandates that every person subject to a listed Indiana tax keep books and records, including all source documents "so that the [D]epartment can determine the amount, if any, of the person's liability for that tax by reviewing those books and records." IC § 6-8.1-5-4(a).

2. Qualified Research Projects.

For income tax purposes, Indiana follows the federal tax scheme with certain modifications. IC § 6-3-1-3.5(b). Indiana provides tax credits outlined in IC 6-3.1 which a taxpayer may claim to reduce its taxable income. One of the tax credits is the "Indiana qualified research expense" tax credit under IC § 6-3.1-4-2(a), which states that, "A taxpayer who incurs Indiana qualified research expense in a particular taxable year is entitled to a research expense tax credit for the taxable year." IC § 6-3.1-4-1 defines the credit. In part, this statute - in effect for the taxable years in question - provides:

> "Indiana qualified research expense" means qualified research expense that is incurred for research conducted in Indiana. "Qualified research expense" means qualified research (as defined in Section 41(b) of the Internal Revenue Code as in effect on January 1, 2001).

Further, "qualified research expense" under the 2003 Indiana Statute is "as defined in Section 41(b) of the Internal Revenue Code as in effect on January 1, 2001[.]" IC § 6-3.1-4-1 (2003) (emphasis added). "Qualified research" is defined in the Internal Revenue Code ("IRC") under section 41(d). IRC subsection 41(d) defines qualified research in pertinent part as follows:

> (d) Qualified research defined.-For purposes of this section-
> (1) In general.-The term "qualified research" means research-
> (A) with respect to which expenditures may be treated as expenses under section 174,
> (B) which is undertaken for the purpose of discovering information-
> (i) which is technological in nature, and-
> (ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and
> (C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph.

I.R.C. § 41(d)(1).

This provision sets out a four-pronged test for qualified research. First, the research must have qualified as a business deduction under § 174. *See Id.* § 41(d)(1)(A). Second, the research must be undertaken to "discover information which is technological in nature." *Id.* § 41(d)(1)(B)(i). Third, the taxpayer must intend to use the information to develop a new or improved business component. *Id.* § 41(d)(1)(B)(ii). Finally, the taxpayer must pursue a "process of experimentation" during substantially all of the research. *Id.* § 41(d)(1)(C).

The Department's audit report stated that Taxpayer's projects did not meet the I.R.C. § 41 requirements. In particular, the report states that the projects did not meet the requirement set out in I.R.C. § 41(d)(4)(B), (C) which states that "qualified research" does not include the:

> (B) Adaptation of existing business components.--Any research related to the adaptation of an existing business component to a particular customer's requirement or need.
>
> (C) Duplication of existing business component.--Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

Treas. Reg. 1.41-4(a)(3)(i) (T.D. 8930) that "qualified research" consists of "discovering information":

> For purposes of section 41(d) and this section, research is undertaken for the purpose of *discovering information* only if it is undertaken to obtain knowledge that exceeds, expands, or *refines the common knowledge* of skilled professionals in a particular field of science or engineering. (*Emphasis added*).

Treas. Reg. 1.41-4(a)(3)(ii) (T.D. 8930) defines common knowledge:

> Common knowledge of skilled professionals in a particular field of science or engineering means information that should be known to skilled professionals had they performed, before the research in question is undertaken, a reasonable investigation of the existing level of information in the particular field of science or engineering.

The audit concluded that Taxpayer was not engaged in "qualified research" under T.D. 8930 because Taxpayer was not engaged in activities that required it to develop information that "exceeds, expands or refines the common knowledge of skilled engineering professionals." The audit report concluded:

> The projects for which the credit was calculated are adaptations of an existing business component. [Taxpayer's] projects are not developing new or improved business components.

3. Conclusion.

a. Qualified Research Activities.

The Department is unable to agree that Taxpayer's project activities - despite their complexity and sophistication - constitute qualified research activities because the activities fall outside the relevant law. Although Taxpayer's activities are intended to resolve construction and design problems, the activities do not result in a "[n]ew or improved business component." I.R.C. § 41(d)(1)(B)(ii). While Taxpayer strives to optimize the installation of lighting, communication, and electrical components, Taxpayer's work does not result - for example - in the development of a new and improved switches; it does not result in the discovery of new, improved, and more efficient LEDs; it does not result in the development and discovery of a lighter, less expensive, more malleable form of electrical conduit. *See also* Treas. Reg. 1.41-4(a)(3)(i).

Rather than "discovering" improved electrical devices, Taxpayer's activities specifically fall within what the law proscribes. As set out in I.R.C. § 41(d)(4)(B), qualified research activities does not include "research related to adaptation of existing business components . . . ." Taxpayer works with, adapts, and installs electrical components all of which - based on Taxpayer's own description - consists of lighting, electrical conduit, switches, control devices, and communication systems the implementation of which falls within the "common knowledge" of "skilled professionals" such as Taxpayer. As Taxpayer itself described, Taxpayer performs field examinations and evaluates existing utility services before embarking on a construction project. However, there is no indication that these efforts result in a new and improved "business component."

None of this is intended to minimize or disparage the work that Taxpayer performs. But as to the question of whether Taxpayer is "discovering information" through a "process of experimentation" resulting in a "new business component," it is not.

b. Wage Documentation and Substantiation.

Setting aside issues related to Taxpayer's electrical contract projects, Taxpayer disagrees with the audit's finding that Taxpayer failed to adequately document its employees' specific activities related to those projects. Taxpayer admitted that it "did not maintain a system of project accounting . . . used to quantify the company's research expenses accurately" but relied on "interviews and estimates to substantiate the amount of qualified research activities incurred."

Treas. Reg. 1.41-4(d) (TD 8930) sets out the record keeping and documentation requirement for expenses related to the research credit:

> No credit shall be allowed under section 41 with regard to an expenditure relating to a research project unless the taxpayer - (1) Prepares documentation before or during the early stages of the research project, that describes the principal questions to be answered and the information the taxpayer seeks to obtain to satisfy the requirements of paragraph (a)(3) of this section, and retains that documentation on paper or electronically in the manner prescribed in applicable regulations, revenue rulings, revenue procedures, or other appropriate guidance until such time as taxes may no longer be assessed (except under section 6501(c)(1), (2), or (3)) for any year in which the taxpayer claims to have qualified research expenditures in connection with the research project; and (2) Satisfies section 6001 and regulations there under.

Indiana provides its own record keeping requirements.

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts and canceled checks. IC § 6-8.1-5-4(a).

It is the Taxpayer's statutory obligation to maintain and produce to the Department records sufficient to verify the credits which it claims pursuant to IC § 6-3.1-4-1 and IC § 6-8.1-5-4. This is especially true in the case of the RECs for which the I.R.C. imposes stringent and detailed parameters and which - if Taxpayer seeks to obtain the benefit of those credits - Taxpayer is required to meet. Treas. Reg. 1.41-4(d) (TD 8930).

Indiana case law speaks to the issue of the documentation required to establish one's entitlement to credits such as that sought by Taxpayer. "Tax credits are a matter of legislative grace, and taxpayers bear the burden of proving they are entitled to claim tax credits." *IDOPCP, Inc. v. Comm'r*, 503 U.S. 79, 84 (1992). Moreover, where such a credit is claimed, "the party claiming the same must show a case, by sufficient evidence, which is clearly within the **exact letter of the law**." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 100-01 (Ind. Ct. App. 1974) (**Emphasis added**). Thus, every taxpayer's claims against any tax must be supported by records necessary to substantiate the claimed credits.

Following the February 2018 hearing, Taxpayer prepared documentation, spreadsheets, and detailed explanations of the methodology which - after Taxpayer made its original expense estimates - purport to support Taxpayer's original estimates. For example, Taxpayer originally estimated that each of its project foreman dedicated 25 percent of their time to conducting qualified research; Taxpayer estimated that its journeymen employees dedicated between 0 and 4 percent of their time conducting qualified research.

In its follow-up explanation and documentation, Taxpayer applied a statistical scaling adjustment to reconcile its originally filed estimates to the sampled projects and each employee's tracked time.

Taxpayer points out that various courts have affirmed "the use of estimates to quantify expenses associated with qualified research activities." For example, Taxpayer cites to *Suder v. Commissioner of Internal Revenue*, T.C. Memo. 2014-201 (T.C. October 1, 2014). Taxpayer explains its reliance:

> [In *Suder*] the Tax Court found that [] one individual's testimony, taking into account his institutional knowledge of the company's employees and their respective activities, constituted a reasonable basis to estimate all qualified employee wage expenses.

Even in the face of Taxpayer's efforts to quantify the claimed wage expenses, the Department concludes that Treas. Reg. 1.41-4(d), Indiana statutes, and Indiana case law mandate that taxpayers seeking these credits maintain and retain contemporaneous records sufficient to establish that its employees engaged in the claimed activities. In this case, taxpayer has failed to prepare and maintain documentation "before or during the early stages of the research project" as required by Treas. Reg. 1.41-4(d). Had Taxpayer established that it conducted qualifying activities, the Department would have considered Taxpayer's estimates if the presumptions underlying those estimates could have been established.

The Department acknowledges Taxpayer's conscientious and detailed efforts to verify and quantify its original wage expenses but must decline Taxpayer's invitation to defer to the cited authorities' standard typified in the *Suder* decision and wholeheartedly accept Taxpayer's expense analysis without the "sufficient and credible documentary evidence to support the estimated percentages" provided during that case. *Suder*, T.C. Memo. 2014-201 at 22. As it has in previous administrative decisions on this issue, Taxpayer is reminded that Indiana's REC statute and Indiana's application of the credit does not fully parallel the federal standard which therefore places on the Department the responsibility of interpreting and administering that Indiana credit.

The Department is unable to agree that Taxpayer has established that its design and implementation of electrical contract projects led to the discovery and deployment of improved methods of installing electrical components which then became part of the body of common knowledge of other skilled electrical contractors.

FINDING

Taxpayer's protest is respectfully denied.

March 17, 2018

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An html version of this document.